

Report  
of the  
Examination of  
Mortgage Guaranty Reinsurance Corporation  
Milwaukee, Wisconsin  
As of December 31, 1997

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February 26, 1999

Honorable Connie L. O'Connell  
Commissioner of Insurance  
State of Wisconsin  
121 East Wilson Street  
Madison, WI 53702

Commissioner:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

MORTGAGE GUARANTY REINSURANCE CORPORATION  
Milwaukee, WI

and this report is respectfully submitted.

## **I. INTRODUCTION**

The previous examination of the company was conducted in 1993 as of December 31, 1992. The current examination covered the intervening period ending December 31, 1997, and included a review of such 1998 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Employees' Welfare and Pension Plans
- Territory and Plan of Operations
- Affiliated Companies
- Growth of Company
- Reinsurance
- Financial Statements
- Accounts and Records
- Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

## **II. HISTORY AND PLAN OF OPERATION**

Mortgage Guaranty Reinsurance Corporation (MGRC) was incorporated under the laws of Wisconsin on September 30, 1985. The company was organized to assume a 20% portion of the run-off business assumed by the MGIC Group from Wisconsin Mortgage Assurance Corporation (WMAC), discussed below. Initial capitalization of MGRC included 100% of the Class A common capital stock of Mortgage Guaranty Insurance Corporation, contributed by MGIC Investment Corporation. The company is licensed solely in the state of Wisconsin.

Effective February 28, 1985, MGIC Investment Corporation and its subsidiaries acquired certain assets, liabilities, and operations of the former MGIC Investment Corporation and its subsidiaries pursuant to an Agreement and Plan of Acquisition and Assumption (Assumption). The residential mortgage guaranty operations of the former MGIC Investment Group remained with Wisconsin Mortgage Assurance Corporation, which was placed under the supervision of the Wisconsin Office of the Commissioner of Insurance. All of the net retained liability under policies in force was reinsured by a group of European reinsurers (Assumption). Pursuant to the Assumption, MGIC assumed 100% of WMAC's residential mortgage insurance claim reserve and liability for defaulted policies effective February 28, 1985, and assumed through a retrocession reinsurance assumption 20% of the net insurance in force, for certain rights and assets (Retrocession). The remaining 80% of the WMAC net insurance in force remained in the assuming European reinsurers. MGIC managed the run-off of the WMAC business.

Effective September 30, 1985, MGIC assigned its 20% participation under the WMAC assumption agreement to MGRC, and MGRC was substituted for MGIC under the retrocession transaction. MGIC remained liable for any and all defaults reported from March 1, 1985, through September 30, 1985. MGIC provided all of the administrative services and cash operations needed to the run-off of the block of business. For the years 1985 through 1994, losses on the 20% MGRC participation exceeded premiums. MGIC, as administrator, paid claims on behalf of MGRC, and annually had a receivable for expenses and claims paid in excess of revenues, corresponding to a claims payable liability in MGRC. MGIC was compensated annually for its payment of expenses and claims in excess of premiums through repurchase of shares of its

Class A common capital stock from MGRC. Beginning in 1995, the annual claims paid by MGIC for MGRC were less than the annual premium revenue from the remaining in-force policies on the block of business, and MGRC did not have a year-end liability for excess claims. There were no further treasury stock transactions between MGRC and MGIC from 1995 through 1998.

Through a series of Assignment, Assumption and Release agreements, MGIC replaced several of the Assumption reinsurers, and as of December 31, 1997, MGIC became the lead reinsurer on the book of business, having a 65.6% participation in the Assumption block of business. Effective April 1, 1996, the former lead reinsurer in the 1985 Assumption transferred its liability to MGIC, and MGIC became the reinsurer retroceding to MGRC under the 1985 Assignment and Substitution agreement. Effective December 31, 1998, MGIC purchased all of the outstanding capital stock of WMAC, and acquired the assets and liabilities of WMAC, pursuant to a court approved plan of rehabilitation for run-off of the remaining book of business.

The following table is a summary of the net insurance premiums written by the company in 1997. The growth of the company is discussed in the Financial Data section of this report.

<b>Line of Business</b>	<b>Direct Premium</b>	<b>Reinsurance Assumed</b>	<b>Reinsurance Ceded</b>	<b>Net Premium</b>
Mortgage guaranty	<u>\$0</u>	<u>\$3,175,141</u>	<u>\$0</u>	<u>\$3,175,141</u>
Total All Lines	<u>\$0</u>	<u>\$3,175,141</u>	<u>\$0</u>	<u>\$3,175,141</u>

### III. MANAGEMENT AND CONTROL

#### Board of Directors

The board of directors consists of three members. All directors are elected annually to serve a one-year term. Members of the company's board of directors may also be members of other boards of directors in the holding company group. As officers of the company, the board members currently receive no compensation for serving on the board.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
William H. Lacy West Bend, WI	Chairman MGIC Investment Corp.	1999
J. Michael Lauer Wauwatosa, WI	Executive Vice President and CFO MGIC Investment Corp.	1999
Joseph J. Ziino, Jr. Brookfield, WI	Senior Vice President, Associate General Counsel, and Assistant Secretary MGIC Investment Corporation	1999

#### Officers of the Company

Officers are appointed at the board of directors' annual meeting. The officers appointed by the board of directors and serving at the time of this examination are listed below. All officers are employed by Mortgage Guaranty Insurance Corporation, and a portion of their compensation is allocated to Mortgage Guaranty Reinsurance Corporation through a servicing agreement.

Name	Office
William H. Lacy	Chairman of the Board and President
J. Michael Lauer	Executive Vice President and Chief Financial Officer
Jeffrey H. Lane	Senior Vice President, General Counsel, and Secretary
Joseph J. Ziino, Jr.	Vice President, Assistant General Counsel, and Assistant Secretary

#### Committees of the Board

The company had no committees at the time of the examination.

### IV. AFFILIATED COMPANIES

Mortgage Guaranty Reinsurance Corporation (MGRC) is a member of a holding company system. The ultimate parent of the holding company system is MGIC Investment Corporation. MGIC Investment Corporation is a publicly traded corporation listed on the New York Stock Exchange. As of December 31, 1997, the holding company's largest shareholder was The Northwestern Mutual Life Insurance Company (NML), which held an 18% ownership interest.

MGIC Investment Corporation and each of its subsidiaries qualifying under the Internal Revenue Code join in filing a consolidated federal income tax return, pursuant to an MGIC Group affiliated tax-sharing agreement. Tax benefit or liability attributed to each respective affiliate under the consolidated income tax return is based on the amount of benefit or liability that would otherwise have applied if the respective affiliate had filed a separate United States Corporation Income Tax Return. For purposes of income tax-sharing, each subsidiary computes its own income on a separate company basis, and each computes its own taxes by applying on a separate company basis the provisions of the Internal Revenue Code.

MGIC provides employee personnel, management services, and administrative services to various companies in the MGIC Group through an intercompany services allocation agreement. MGIC costs for services provided to each affiliate are allocated by MGIC to the respective affiliate.

The organizational chart below depicts the relationships among the affiliates in the group. A brief description of the holding company affiliates of Mortgage Guaranty Reinsurance Corporation follows the organizational chart.



**Organizational Chart  
As of December 31, 1997**

MGIC Investment Corporation  
    Mortgage Guaranty Reinsurance Corporation  
        (1) Mortgage Guaranty Insurance Corporation  
            MGIC Reinsurance Corporation of Wisconsin  
            MGIC Mortgage Insurance Corporation  
            MGIC Credit Assurance Corporation  
            MGIC Surety Corporation  
            MGIC Assurance Corporation  
            MGIC Real Estate Servicing Corporation  
            Credit-Based Asset Servicing & Securitization LLC  
    MGIC Reinsurance Corporation  
    MGIC Mortgage Reinsurance Corporation  
    MGIC Residential Reinsurance Corporation  
    MGIC Mortgage Marketing Corporation  
    MGIC Investor Services Corporation  
    MGIC Insurance Services Corporation  
    MGIC Mortgage Securities Corporation

(1) Mortgage Guaranty Reinsurance Corporation owns 41,085 shares of the outstanding Class A common capital stock of Mortgage Guaranty Insurance Corporation (MGIC). MGIC holds the remaining 58,915 shares of the Class A capital stock issue as treasury stock. MGIC Investment Corporation owns 100% of the outstanding shares of Class B common capital stock of MGIC.

**MGIC Investment Corporation (MTG)**

MGIC Investment Corporation (MTG) was incorporated under the laws of Wisconsin on June 22, 1984, as Management Financing Corporation. The holding company's name was changed to MGIC Investment Corporation effective March 1, 1985. The holding company was formed to consolidate ownership of, and to provide capitalization for, the mortgage guaranty insurance and related business operations of the MGIC Group. Initial funding of MTG was provided by NML and by senior executive officers of MGIC. An initial public offering of the common stock of MTG was completed in August of 1991, and a second offering was completed in June of 1992.

At year-end 1997 NML held an 18.4% ownership interest in MTG, officers and directors of MTG held 1.3% ownership interest, and other investors held the remaining 80.3% of ownership. In August 1998 NML sold 43% of its then existing holdings of MTG stock, reducing its present ownership interest in the holding company to approximately 10.5%.

MTG and its subsidiary companies are principally engaged in the mortgage guaranty insurance business. The group provides residential mortgage insurance and related insurance

products to lenders, and through its noninsurance operations provides services to the mortgage finance industry, including contract underwriting, claim administration, and portfolio analysis.

As of December 31, 1997, MTG's audited financial statement reported assets of \$2,617,687,000, liabilities of \$1,130,905,000, and total shareholder's equity of \$1,486,782,000. Operations for 1997 produced net income of \$323,750,000.

### **Mortgage Guaranty Insurance Corporation (MGIC)**

MGIC was incorporated under the laws of Wisconsin on February 20, 1979, as Liberty Mortgage Insurance Company. The company was originally owned by Verex Corporation, and was acquired by MGIC Investment Corporation in November 1984. The company's corporate name was changed to the one presently used on March 1, 1985, when the company began writing new business. The Class A common stock of MGIC was contributed to the capital of MGRC on September 30, 1985.

MGIC issues residential mortgage guaranty insurance in 50 states, the District of Columbia, and Puerto Rico. MGIC serves as the lead company in the MGIC Group, providing administrative and managerial services within the group, accumulating costs, and allocating expenses under affiliated services agreements. MGIC also cedes reinsurance to other members of the group. Run-off business assumed by MGIC from Wisconsin Mortgage Assurance Corporation is assigned to MGRC. MGIC insurance business requiring an AAA-rated insurer is ceded to MGIC Mortgage Insurance Corporation. Business is ceded to other MGIC affiliate insurers for the purpose of meeting the statutory restrictions in some states that limit mortgage guaranty retention for any one risk to not more than 25% of the total risk.

As of December 31, 1997, MGIC's statutory financial statement reported admitted assets of \$2,674,174,905, total liabilities of \$2,341,304,242, and policyholder's surplus of \$322,870,663. Operations for 1997 produced net income of \$111,673,740.

### **MGIC Reinsurance Corporation of Wisconsin (MRCW)**

MRCW was incorporated under the laws of Wisconsin on February 15, 1996, and commenced operations on April 1, 1996. The company was established to provide reinsurance to MGIC for its primary and pool mortgage loan policy liabilities in excess of 25% of the mortgage

loan amounts, for policies written in 44 states. The company assumes all of its business from MGIC, and does not cede any of its business.

As of December 31, 1997, MRCW's statutory financial statement reported admitted assets of \$119,589,227, total liabilities of \$35,865,442, and policyholder's surplus of \$83,723,785. Operations for 1997 produced a net loss of \$2,701,384. In 1997 MGIC contributed capital of \$35,000,000 to the company to support MRCW's increased reinsurance assumption activity.

#### **MGIC Mortgage Insurance Corporation (MMIC)**

MMIC was incorporated under the laws of Wisconsin on April 30, 1987. The company was established to be an insurer that maintains the rating AAA by Standard and Poor's Corporation, to provide the MGIC Group with the facility to write mortgage guaranty insurance on loans that require the insurer to be rated AAA. The company assumes coverages issued by MGIC, and does not write any direct insurance business.

Prior to 1996, MMIC was a wholly owned subsidiary of MGIC. In 1996 MGIC contributed 100% of the common stock of MMIC to MGIC Reinsurance Corporation of Wisconsin.

As of December 31, 1997, MMIC's statutory financial statement reported admitted assets of \$61,871,465, total liabilities of \$15,033,563, and policyholder's surplus of \$46,837,902. Operations for 1997 produced net income of \$2,152,386.

#### **MGIC Credit Assurance Corporation (MCAC)**

MCAC was organized under the laws of Wisconsin on April 30, 1997, and commenced business on May 21, 1997. The company was established to write mortgage loan guaranty insurance to lenders in certain states on second mortgages and home equity lines of credit. As of December 31, 1997, MCAC had not undertaken any liability for insurance risks, and did not have any insurance in force.

MCAC is a wholly owned subsidiary of MGIC. The company's initial capitalization, provided in 1997 by MGIC, consisted of \$2,000,000 of paid-in capital and \$3,000,000 of paid-in surplus.

As of December 31, 1997, MCAC's statutory financial statement reported admitted assets of \$5,175,577, total liabilities of \$17,000, and policyholder's surplus of \$5,158,577. Operations for 1997 produced net income of \$158,577.

#### **MGIC Surety Corporation (Surety)**

Surety was organized under the laws of Wisconsin on April 30, 1997, and commenced business on May 21, 1997. The company is licensed in Wisconsin only, to write the surety line of business. As of December 31, 1997, Surety had not undertaken any liability for insurance risks, and did not have any insurance in force.

Surety is a wholly owned subsidiary of MGIC. The company's initial capitalization, provided by MGIC on May 1, 1997, consisted of \$2,000,000 of paid-in capital, \$3,000,000 of paid-in surplus, and 100% of the common stock of MGIC Assurance Corporation, which at the date of transfer had the statement value of \$14,777,942.

As of December 31, 1997, Surety's statutory financial statement reported admitted assets of \$18,943,446, total liabilities of \$4,000, and policyholder's surplus of \$18,939,446. Operations for 1997 produced net income of \$188,970.

#### **MGIC Assurance Corporation (MAC)**

MAC was organized under the laws of Oklahoma in 1937 as Insurers Indemnity and Insurance Company. The company was acquired by MGIC in 1995, and adopted its current corporate name and redomesticated to Wisconsin effective November 18, 1996.

During 1997 the company began writing insurance on second mortgages and home equity lines of credit, and had direct business in two states. At year-end 1997 the company was licensed in 23 states as a credit insurer, and in an additional 15 states in other lines of insurance. Wisconsin regulations require that a mortgage guaranty or junior lien insurer be a monoline company, or otherwise establish a segregated account for the capitalization of mortgage guaranty or junior lien business. In 1997 the company established a segregated account through which it conducts its junior lien insurance business.

The company is a wholly owned subsidiary of MGIC Surety Corporation, with 100% of its common stock having been contributed by MGIC to Surety in 1997. During 1997 MGIC

contributed paid-in capital of \$5,000,000 to the segregated account of MGIC Assurance Corporation to capitalize the company's mortgage guaranty operations.

As of December 31, 1997, MAC's statutory financial statement reported admitted assets of \$12,530,483, total liabilities of \$571,899, and policyholder's surplus of \$11,958,585. Operations for 1997 produced net income of \$307,514.

#### **MGIC Real Estate Servicing Corporation (RESC)**

RESC was formed in the 1980s for the purpose of acquiring, managing, and disposing of real estate acquired through the claim settlement process (REO) generated from the WMAC run-off book of business. The corporation was dissolved effective December 15, 1998, due to decreased WMAC related property acquisition activity, as policies in the WMAC block expire and the size of the run-off business block decreases.

The company serviced REO properties acquired through the settlement of WMAC claims, particularly pool coverage claims where the underlying mortgage loans had a high coupon rate. The company served as a credit facility for financing the acquisition of properties in settlement of claims. Reinsurers participated in the financing of the company as an element of the reinsurers' loss mitigation effort, providing a portion of the total credit facility required to support the REO inventory.

As of December 31, 1997, RESC's unaudited financial statement reported total assets of \$148,673, total liabilities of \$124,328, and total stockholders equity of \$24,345. Operations for 1997 produced a net loss of \$650.

#### **Credit-Based Asset Servicing & Securitization LLC (C-Bass)**

C-Bass is a joint venture in which MGIC has a 48.2% ownership interest. The venture was formed in July 1996 to engage in the acquisition and resolution of delinquent single family mortgage loans. The company purchases and sells mortgage-backed securities, and issues mortgage-backed debt securities collateralized by mortgage loans and mortgage securities. The MGIC Group does not have material participation in subperforming loans of the type owned by C-Bass.

As of December 31, 1997, C-Bass' audited financial statement reported total assets of \$224,149,940, total liabilities of \$163,636,879, and member's equity of \$60,513,061.

Operations for 1997 produced net income of \$15,204,392.

#### **MGIC Reinsurance Corporation (MGIC Re)**

MGIC Re was incorporated under the laws of Wisconsin on February 21, 1985, and commenced business on March 1, 1985. The company was organized to provide the affiliated company MGIC with excess of loss reinsurance coverage. MGIC Re provides reinsurance to MGIC on primary and pool mortgage guaranty coverage in excess of 25% of the loan amount, on business written in 6 states. The company's reinsurance on any loan is limited to a maximum of 25% of the loan amount. The company assumes all of its business from MGIC, and cedes to a group of foreign reinsurers to increase capacity.

As of December 31, 1997, MGIC Re's statutory financial statement reported admitted assets of \$55,307,666, total liabilities of \$24,235,385, and policyholder's surplus of \$31,072,281.

Operations for 1997 produced net income of \$1,143,835.

#### **MGIC Mortgage Reinsurance Corporation (MMRC)**

MMRC was organized under the laws of Wisconsin on July 1, 1996, and commenced business activity on that date. MMRC was organized to provide the affiliated company MGIC with excess of loss reinsurance coverage. MMRC provides reinsurance to MGIC on mortgage guaranty pool coverage in excess of 25% of the loan amount on business written in 6 states. The company's reinsurance on any loan is limited to a maximum of 25% of the loan amount. The company assumes all of its business from MGIC, and does not cede any of its business.

As of December 31, 1997, MMRC's statutory financial statement reported admitted assets of \$10,816,761, total liabilities of \$66,802, and policyholder's surplus of \$10,749,959.

Operations for 1997 produced net income of \$498,422.

#### **MGIC Residential Reinsurance Corporation (MRRC)**

MRRC was organized under the laws of Wisconsin on July 1, 1996, and commenced business on that date. MRRC was organized to provide the affiliated company MGIC with excess of loss reinsurance coverage. MGIC Residential Reinsurance Corporation provides reinsurance

to MGIC on mortgage guaranty coverage in excess of 25% of the loan-to-value amount on business written in 6 states. The company's reinsurance on any loan is limited to a maximum of 25% of the loan amount. The company assumes all of its business from MGIC, and does not cede any of its business.

As of December 31, 1997, MRRC's statutory financial statement reported admitted assets of \$10,784,995, total liabilities of \$66,975, and policyholder's surplus of \$10,718,020. Operations for 1997 produced net income of \$484,766.

#### **MGIC Mortgage Marketing Corporation (MMC)**

MMC was incorporated under the laws of Wisconsin on October 1, 1984, as MFC Marketing Corporation. The company's name was changed to MGIC Mortgage Marketing Corporation effective March 1, 1985. MMC purchases mortgage loans, assembles those loans into pools, and markets the pooled loans by issuance of mortgage pass-through certificates. MMC does not take an investment position in the pass-through certificates.

As of December 31, 1997, MMC's audited financial statement reported total assets of \$1,771,000, total liabilities of \$219,000, and total shareholder's equity of \$1,552,000. Operations for 1997 produced a net loss of \$68,000.

#### **MGIC Investor Services Corporation (MISC)**

MISC was incorporated under the laws of Wisconsin as MFC Services Corporation. The company's name was changed to the one presently used on March 1, 1985, when MISC began its principal business activities. MISC provides business services for the home mortgage finance industry, including portfolio analysis, due-diligence underwriting, secondary marketing of related assets, contract underwriting, and consulting. MISC also provides claims administration services and premium reconciliation services for two U.S. government agencies.

As of December 31, 1997, MISC's audited financial statement reported total assets of \$15,190,000, total liabilities of \$3,448,000, and total shareholder's equity of \$11,742,000. Operations for 1997 produced a net loss of \$780,000.

**MGIC Insurance Services Corporation (INS)**

INS was incorporated under the laws of Wisconsin on February 26, 1985. The company commenced business on April 1, 1985. INS acts as a broker for insurance coverages offered to financial institutions, and manages surety, special hazard, and mortgage-related bonds and policies issued by Continental Casualty Company (including existing bonds and policies of WMBIC Indemnity Corporation assumed by Continental Casualty Company) including issuance of coverage, premium collection, and claims.

As of December 31, 1997, INS's unaudited financial statement reported total assets of \$287,355, total liabilities of \$65,103, and total stockholder equity of \$222,251. Operations for 1997 produced net income of \$170,498.

**MGIC Mortgage Securities Corporation (MSC)**

MSC was incorporated under the laws of Wisconsin on October 1, 1984, as MFC Securities Corporation. The company's name was changed to the one presently used effective March 1, 1985, when the company commenced its principal business activities. MSC is a registered broker and dealer in securities under the Securities Exchange Act of 1934. MSC functions as a broker/dealer in the purchase and sale of mortgage-backed securities including mortgage pass-through securities. The company's clients are financial institutions such as mortgage lenders and security dealers.

As of December 31, 1997, MSC's audited financial statement reported total assets of \$424,000, total liabilities of \$14,000, and total shareholder's equity of \$410,000. Operations for 1997 produced net income of \$2,000.



## **V. REINSURANCE**

Mortgage Guaranty Reinsurance Company's reinsurance portfolio and strategy is described below. The company's reinsurance contract contains proper insolvency provisions.

Effective February 28, 1985, the old MGIC (now known as Wisconsin Mortgage Assurance Corporation, or WMAC) ceased writing new business and reinsured with a group of European reinsurers, on a quota share basis, 100% of its net retained liability under its policies in force (Assumption). Effective the same date, the lead European reinsurer retroceded 20% of the 100% block to MGIC (Retrocession). Also effective on February 28, 1985, MGIC assumed WMAC's liability under policies in default as of that date, in return for certain assets.

Effective September 30, 1985, MGIC assigned its interests under the Retrocession to MGRC, and MGRC was substituted for MGIC under the Retrocession agreement. MGRC thereby became the reinsurer under the Retrocession, having all rights and obligations under the Retrocession assumption on or after October 1, 1985 (Assignment and Substitution). MGIC retained all liability under the Retrocession for defaulted risks reported from March 1, 1985, through September 30, 1985.

As noted earlier in this report, some of the reinsurers who were party to the 1985 Assumption assigned their rights and obligations under the Assumption to successor reinsurers. Through these agreements, MGIC replaced several of the Assumption reinsurers, and as of December 31, 1997, MGIC became the lead reinsurer on the book of business, having a 65.6% participation in the Assumption block of business. Effective April 1, 1996, the lead reinsurer in the 1985 Assumption transferred its liability to MGIC, and MGIC became the reinsurer retroceding to MGRC under the 1985 Assignment and Substitution agreement.

Certain policies included in the WMAC block of business were rewritten for the purpose of claim mitigation. Since WMAC was no longer a licensed insurer, the policies were directly written by MGIC and ceded facultatively on a quota share basis, 80% to the WMAC foreign reinsurers and 20% to MGRC. The facultative cessions were subject to the approval of the European reinsurers. As noted above, MGIC has replaced several of the Assumption

reinsurers, and MGIC's quota share ceding percentage on the facultative treaty is currently 54.4%, ceding 20% to MRGC and the remainder to WMAC foreign reinsurers.

MGIC administered the Assumption and the Retrocession for MGRC in return for a management fee.

The company's reinsurance treaty in force at the time of the examination is summarized below.

**Affiliated Assumption Contract**

1. Type:	Retrocession Quota Share Reinsurance (in run-off)
Reinsured:	Mortgage Guaranty Insurance Corporation
Scope:	The reinsured's rights and obligations under a certain quota share treaty reinsuring 20% of WMAC's net retained liability under its policies in force, not in default, at September 30, 1985 (Underlying Agreement)
Coverage:	100% of the reinsured's liability under the underlying agreement
Premium:	All premiums received pursuant to the retrocession
Effective date:	September 30, 1985
Termination:	The agreement will remain in force until the expiration of all covered policies under the underlying agreement.
MGIC replacement:	The contract was originally effective September 30, 1985, with the ceding company being European General Reinsurance Company (EGRC). EGRC was the reinsurer of the subject block of risks, retroceding the risks to MGRC. Effective April 1, 1996, EGRC transferred its liability under its assumption of the risks to MGIC, and MGIC replaced EGRC as the reinsurer of the risks, retroceding to MGRC under the 1985 treaty.

## **VI. FINANCIAL DATA**

The following financial statements reflect the financial condition of the company as reported in the December 31, 1997, statutory annual statement to the Commissioner of Insurance. Examination adjustments to account balances made as a result of examination findings are noted on the page captioned "Reconciliation of Surplus per Examination." Also included in the Financial Data section are schedules which reflect the growth of the company, comment on any exceptional NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the company's Mortgage Guaranty Insurers Report of Policyholder Position as of December 31, 1997.

**Mortgage Guaranty Reinsurance Corporation**  
**Assets**  
**As of December 31, 1997**

	<b>Ledger Assets</b>	<b>Nonledger Assets</b>	<b>Nonadmitted Assets</b>	<b>Admitted Assets</b>
Bonds	\$ 22,260,277	\$ 0	\$0	\$ 22,260,277
Stocks:				
Common stocks	94,341,072	195,152,052	0	289,493,124
Cash	595	0	0	595
Short-term investments	10,478,537	0	0	10,478,537
Federal income tax recoverable	0	5,225,985	0	5,225,985
Interest, dividends, and real estate income due and accrued	<u>0</u>	<u>394,095</u>	<u>0</u>	<u>394,095</u>
Total Assets	<u>\$127,080,481</u>	<u>\$200,772,132</u>	<u>\$0</u>	<u>\$327,852,613</u>

**Mortgage Guaranty Reinsurance Corporation**  
**Liabilities, Surplus, and Other Funds**  
**As of December 31, 1997**

Losses	\$ 19,557,184
Loss adjustment expenses	432,719
Unearned premiums	16,522
Payable to parent, subsidiaries, and affiliates	49,381
Write-ins for liabilities:	
Funds held for the benefit of Wisconsin Mortgage Assurance Corporation	<u>1,463,384</u>
 Total Liabilities	 21,519,190
 Common capital stock	 2,000,000
Gross paid-in and contributed surplus	229,055,234
Unassigned funds (surplus)	<u>75,278,189</u>
 Surplus as Regards Policyholders	 <u>306,333,423</u>
 Total Liabilities, Surplus, and Other Funds	 <u>\$327,852,613</u>

**Mortgage Reinsurance Corporation**  
**Summary of Operations**  
**For the Year 1997**

**Underwriting Income**

Premiums earned	\$ 3,176,711
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**Deductions**

Losses incurred	489,775
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Loss expenses incurred	117,626
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Other underwriting expenses incurred	7,250
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Write-ins for underwriting deductions:

Contingency reserve contribution of 50% of earned premium less withdrawal	<u>1,588,356</u>
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Total underwriting deductions	<u>2,203,007</u>
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Net underwriting gain or loss	973,704
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**Investment Income**

Net investment income earned	<u>640,834</u>
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Net investment gain or loss	640,834
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**Other Income**

Total other income	<u>0</u>
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Net income before dividends to policyholders and before federal and foreign income taxes	<u>1,614,538</u>
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Net income after dividends to policyholders but before federal and foreign income taxes	1,614,538
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Federal and foreign income taxes incurred	<u>(33,771,000)</u>
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Net Income	<u>\$ 35,385,538</u>
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**Mortgage Guaranty Reinsurance Corporation**  
**Cash Flow**  
**As of December 31, 1997**

Premiums collected net of reinsurance	\$ 3,175,140	
Loss and loss adjustment expenses paid (net of salvage or subrogation)	2,069,311	
Underwriting expenses paid	<u>7,250</u>	
Cash from underwriting		\$ 1,098,579
Investment income (net of investment expense)	283,509	
Total other income	0	
Deduct:		
Federal income taxes paid (recovered)		<u>(28,627,575)</u>
Net cash from operations		\$ 30,009,663
Proceeds from investments sold, matured, or repaid:		
Stocks	<u>25,490,579</u>	
Total investment proceeds	25,490,579	
Cost of investments acquired (long-term only):		
Bonds	20,924,493	
Stocks	<u>24,657,624</u>	
Total investments acquired		<u>45,582,117</u>
Net cash from investments		(20,091,538)
Cash provided from financing and miscellaneous sources:		
Total	0	
Cash applied for financing and miscellaneous uses:		
Net transfers to affiliates	68,608	
Other applications	<u>371,008</u>	
Total		<u>439,616</u>
Net cash from financing and miscellaneous sources		<u>(439,616)</u>
Net change in cash and short-term investments		9,478,509
<b>Reconciliation</b>		
Cash and short-term investments, December 31, 1996		<u>1,000,623</u>
Cash and short-term investments, December 31, 1997		<u>\$ 10,479,132</u>

**Mortgage Guaranty Reinsurance Corporation**  
**Policyholder Position Calculation**  
**December 31, 1997**

A Wisconsin-domiciled mortgage guaranty insurer is required to annually complete and file with the Commissioner a Mortgage Guaranty Insurers Report of Policyholder Position, pursuant to s. Ins 3.09 (5), Wis. Adm. Code. Mortgage Guaranty Reinsurance Corporation has been exempted from the requirement, as the company's only written business consists of a small block of mortgage guaranty risks that is in run-off. The majority of the company's assets consist of its ownership of subsidiary insurers engaged in mortgage guaranty insurance, each of whom individually is required to comply with the Wisconsin requirement for reporting policyholder position.



**Mortgage Guaranty Reinsurance Corporation**  
**Reconciliation and Analysis of Surplus**  
**For the Five-Year Period Ending December 31, 1997**

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>
Surplus, beginning of year	\$152,478,770	\$162,345,928	\$152,493,089	\$161,744,784	\$193,504,924
Net income	1,040,235	1,064,145	2,370,285	2,825,008	35,385,538
Net unrealized capital gains or (losses)	8,826,923	(10,916,984)	6,761,924	28,935,132	77,136,979
Extraordinary amounts of taxes from prior years			119,486		305,982
Surplus, end of year	<u>\$162,345,928</u>	<u>\$152,493,089</u>	<u>\$161,744,784</u>	<u>\$193,504,924</u>	<u>\$306,333,423</u>

**Mortgage Guaranty Reinsurance Corporation**  
**Insurance Regulatory Information System**  
**Exceptional Ratio Results**  
**For the Five-Year Period Ending December 31, 1997**

The following is a summary of NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, for years in which the company had IRIS ratio results that were outside the usual range of values. The summary of IRIS ratio data is followed by discussion of the exceptional ratio results.

Ratio No. 4-Two-year Overall Operating Ratio

NAIC exceptional results are any values greater than or equal to 100%

	<u>Year</u>	<u>Ratio</u>
Company Results-	1993	127.0
	1994	106.0

Ratio No. 5-Investment Yield

NAIC exceptional results are any values greater than or equal to 10% or less than or equal to 4.5%

	<u>Year</u>	<u>Ratio</u>
Company Results-	1993	0.0
	1994	0.0
	1995	0.0
	1996	0.1
	1997	0.2

Ratio No. 6-Change in Capital and Surplus

NAIC exceptional results are any values greater than or equal to 50% or less than or equal to -10%

	<u>Year</u>	<u>Ratio</u>
Company Results-	1997	58.0

Ratio No. 7-Liabilities to Liquid Assets

NAIC exceptional results are any values greater than or equal to 105%

	<u>Year</u>	<u>Ratio</u>
Company Results-	1993	999.0
	1994	999.0
	1995	999.0
	1996	538.0

All of the unusual ratio results experienced by the company during the period under examination arise, at least partially, from the effect of the large company's investment in affiliated common stock assets. The company's investment in affiliated common stocks equaled more

than 99% of invested assets in each of the years under review except in 1997, when affiliated investments equaled 91% of invested assets.

IRIS ratio number 4, Two-year Overall Operating Ratio, measures profitability and includes the loss ratio plus the expense ratio minus the investment yield ratio. The company's negligible nonaffiliated investment assets results in an investment yield ratio of zero for IRIS ratio computation purposes. In addition, the company had a high loss ratio and expense ratio in 1993 and in 1994, all of the above factors contributing to the unusual result for IRIS ratio number 4 in those years. Similarly, the investment yield of zero caused the unusual results for ratio number 5, Investment Yield, in each of the years under examination.

The unusual result for ratio number 6, Change in Capital and Surplus, in 1997 was due to unrealized capital gains of \$77 million in the valuation of the company's investment in affiliated common stocks.

The unusual results for ratio number 7, Liabilities to Liquid Assets, in 1994 through 1996, was due to the effect of the company's affiliated investment in the ratio's computational model. The computation deducts investments in affiliated companies from an insurer's total liquid assets. In the case of the company, the computation results in liquid asset valuation of less than zero, which causes the company's ratio result to be outside the range of usual values.

### Growth of Mortgage Guaranty Reinsurance Corporation

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income
1993	\$187,673,328	\$25,327,400	\$162,345,928	\$ 1,040,235
1994	175,766,845	23,273,756	152,493,089	1,064,145
1995	183,832,877	22,088,093	161,744,784	2,370,285
1996	215,562,276	22,057,352	193,504,924	2,825,008
1997	327,852,613	21,519,190	306,333,423	35,385,538

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss And LAE Ratio	Expense Ratio	Combined Ratio
1993	\$8,633,444	\$8,633,444	\$8,654,301	111.5%	0.8%	112.3%
1994	6,252,291	6,252,291	6,290,795	96.0	0.8	96.8
1995	4,875,921	4,875,921	4,876,850	88.9	0.9	89.8
1996	3,991,236	3,991,236	3,995,137	72.4	12.8	85.2
1997	3,175,141	3,175,141	3,176,711	19.1	50.3	69.4

The company's written premium volume decreased significantly during the period under examination due to the run-off of the WMAC closed block of business that the company participates in as a reinsurer. The number of primary loans in force in the WMAC block decreased from 386,103 at year-end 1993 to 176,817 at year-end 1997. Insurance in force on the WMAC book decreased by 61%, falling from the 1993 risk in force of \$12.7 billion to \$5 billion risk in force at year-end 1997. The year-to-year improvement in the combined ratio is due to the age of the book of business; typically the peak claim period for residential mortgage guaranty is 3-to 5 years into the life of a mortgage, and the remaining WMAC business was first written 14 or more years ago. At this point in the product underwriting cycle, the company is realizing revenue from renewal premiums and claim experience is improved due to the maturity of the remaining policies.

**Reconciliation of Surplus per Examination**

The examination did not make any adjustment to surplus or any reclassification of account balances reported by the company.

## VII. SUMMARY OF EXAMINATION RESULTS

### Compliance with Prior Examination Report Recommendations

There were three specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Management and Control—It is recommended that the board meet formally at least annually to review the operations of the company and adopt the resolutions made at the MGIC Investment Corporation board level, if necessary.

Action—The company is in partial compliance. Further comment and examination recommendation may be found in the Findings section of this report captioned “Management and Control.”

2. Affiliated Transactions—It is recommended that the company update its servicing agreement to include an indemnification clause and a provision for interest.

Action—Compliance.

3. Schedule T—It is recommended that the company complete Schedule T in future annual statements filed with this office.

Action—Compliance.

## **Summary of Current Examination Results**

### **Management and Control**

Review of the minutes of the company's board of directors meetings indicated that the board adequately monitors the results of company operations. Various executive management and decision-making functions are conducted by MGIC Investment Corporation on behalf of all the insurers in the MGIC Group, including the company. Executive functions performed by MGIC Investment Corporation for the company include functions performed by the parent corporation's committees for Securities Investment, Risk Management, Management Development, and Audit. Executive actions performed include management decisions regarding asset investment, policy underwriting, executive compensation, and the selection of independent auditors. The board of directors of the insurance company currently takes no action with regard to the executive decisions enacted by the parent company.

As provided in s. 611.51 (6), Wis. Stat., an insurer's board of directors shall manage the business and affairs of the company, and may not delegate its authority or responsibility to another entity. The company is not in compliance with statutory requirements that the company exercise its board of directors' management authority. The prior-examination also noted this deficiency, and recommended that the company take corrective action. It is again recommended that the company's board of directors review executive decisions made on behalf of the company by the parent corporation, and that the board exercise its responsibility to manage the company by taking action on those decisions, by resolution of the company's board of directors.

### **Custody of Invested Assets**

Company invested assets are held in the custody of a trust bank under an appropriate custodial agreement. However, the safekeeping agreement does not have adequate provisions with regard to the fiduciary responsibility of the custodian. The agreement provides that the custodian will use reasonable care, and limits the liability of the custodian to the company's actual damages at the time a loss is discovered, without reference to any special conditions or circumstances.

The safekeeping agreement is inadequate in that it fails to provide explicit provisions regarding the duties of the custodian. An insurer's custodian agreements should specify the circumstances of loss and the indemnification requirements that apply to the custodian's obligation to indemnify the insurer for loss of assets held in the safekeeping account. It is recommended that the company's custodial agreements expressly provide for the fiduciary obligations of the custodian, to provide that the custodian shall be obligated to indemnify the company for any loss of property of the company that is held in the custodian's custody, for loss arising from the negligence or dishonesty of the custodian's officers or employees, or for loss due to burglary, holdup, theft, or mysterious disappearance, including loss by damage or destruction. It is further recommended that the custodial agreements provide that in the event of a loss of securities for which the custodian is obligated to indemnify the company, the securities or the value of the securities at the time of the loss occurrence shall be promptly replaced, and that the value of any loss of rights or privileges resulting from said loss shall be promptly replaced.



## VIII. SUBSEQUENT EVENTS

Effective May 25, 1999, Mortgage Guaranty Reinsurance Company was dissolved pursuant to a plan of voluntary dissolution and liquidation proposed by Mortgage Guaranty Insurance Corporation and approved in advance by the Commissioner. MGRC was dissolved to simplify the MGIC Group corporate structure and to permit an opportunity for the reallocation of MGRC's capital assets within the MGIC enterprise. Under the plan of dissolution, the remaining liabilities of MGRC were satisfied prior to dissolution, and its remaining net assets were distributed to the sole shareholder. Liabilities of MGRC at the time of dissolution were related solely to the following intercompany agreements:

Liability under the 20% retrocessional quota share reinsurance agreement, effective as of September 30, 1985, between MGIC and MGRC	\$14,726,549
Liability under the 20.8% facultative quota share reinsurance agreement, effective as of July 1, 1987, between MGIC and MGRC	208,459
Tax-sharing liability pursuant to agreement as of January 22, 1986, among MGIC Investment Corporation and affiliates	263,757
Services liability pursuant to servicing agreement as of January 22, 1986, among MGRC, MGIC, and other affiliates	<u>717</u>
Total liabilities at dissolution	\$15,199,462

Prior to dissolution, MGRC executed termination amendments related to the two applicable reinsurance agreements, the tax-sharing agreement, and the servicing agreement, and the respective amounts owed under the agreements were settled. The total amount of MGRC net assets transferred to its sole shareholder, MGIC Investment Corporation, following the settlement of MGRC liabilities and dissolution of the company was \$50,153,888.

The MGRC dissolution plan provided for the ancillary redemption of all 35,000 issued and outstanding shares of Class B common capital stock of MGIC, owned by MGIC Investment Corporation. Under the approved plan, the Class B shares will be redeemed at a price of \$1,000 per share, as permitted by MGIC's articles of incorporation. The redemption of the Class B common stock shares is scheduled to be completed by August 31, 1999.

Upon completion of the redemption, the capital stock ownership of MGIC will consist of Class A common capital stock, par value \$50 per share, 100,000 shares issued, 41,085

outstanding, the remaining 58,915 shares held by MGIC as treasury stock. The Class A stock was held as an asset by MGRC, and was transferred to Investment as an element of the net assets of MGRC. The dissolution of MGRC and distribution of its assets to Investment, and the redemption by Investment of the Class B common capital stock of MGIC, resulted in the following affiliated capital transfers to MGIC Investment Corporation:

1. MGRC net assets in excess of MGIC Class A common stock value	\$50.2 million
2. Redemption of MGIC Class B stock held by Investment	<u>35.0</u> million
Total assets transferred to MGIC Investment Corporation	\$85.2 million

## **IX. CONCLUSION**

Mortgage Guaranty Reinsurance Corporation (MGRC) was established by the MGIC Group in 1985 to participate in a 20% assumption of the run-off of the WMAC book of business. Premiums on the block of business continue to decrease year-to-year as the size of the book decreases due to expiration and cancellation of existing policies. During the years under examination, MGRC written premium decreased by 54% and total risk in force on the WMAC book decreased by 61%, due to policy run-off. The company expects that the diminishing portfolio of policies will probably run-off for the next 15 to 20 years. The company's underwriting performance improved during the examination period, as the remaining policies renewed in the company are matured and are past the typical peak claim period for mortgage guaranty risks.

From 1987 to 1994 the company had unfavorable claim experience. Beginning in 1995 the annual revenues from the company's business exceeded annual losses and expenses.

The examination made two recommendations, pertaining to the board of director's management and control and to provisions in the company's custodial agreements. The examination determined that as of December 31, 1997, the company had assets of \$327,852,613, and liabilities of \$21,519,190. The examination did not make any reclassification of balances or adjustment to surplus. As of December 31, 1997, total surplus was \$306,333,423.

Subsequent to the fieldwork for the current examination, Mortgage Guaranty Reinsurance Corporation was voluntarily dissolved and liquidated. The dissolution, which was effective May 25, 1999, provided for the settlement of all of the company's liabilities, and for the liquidation of its net assets to its parent, MGIC Investment Corporation. In settlement of MGRC liabilities, the company's two assumption reinsurance agreements with MGIC were terminated and MGIC reassumed the risks it formerly ceded to the company. MGRC's ownership interest in MGIC, comprised of all 58,915 issued and outstanding shares of MGIC Class A common capital stock, were transferred to Investment as an element of MGRC net assets.

## **X. SUMMARY OF COMMENTS AND RECOMMENDATIONS**

1. Page 29 - Management and Control—It is again recommended that the company's board of directors review executive decisions made on behalf of the company by the parent corporation, and that the board exercise its responsibility to manage the company by taking action on those decisions, by resolution of the company's board of directors.
2. Page 30 - Custody of Invested Assets— It is recommended that the company's custodial agreements expressly provide for the fiduciary obligations of the custodian, to provide that the custodian shall be obligated to indemnify the company for any loss of property of the company that is held in the custodian's custody, for loss arising from the negligence or dishonesty of the custodian's officers or employees, or for loss due to burglary, holdup, theft, or mysterious disappearance, including loss by damage or destruction. It is further recommended that the custodial agreements provide that in the event of a loss of securities for which the custodian is obligated to indemnify the company, the securities or the value of the securities at the time of the loss occurrence shall be promptly replaced, and that the value of any loss of rights or privileges resulting from said loss shall be promptly replaced.

## **XI. ACKNOWLEDGMENT**

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company is acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, state of Wisconsin, participated in the examination:

<b>Name</b>	<b>Title</b>
Kris DeArmond	Insurance Examiner
Andrew Fell	Insurance Examiner
Teri McClintock	Insurance Examiner

Respectfully submitted,

Thomas E. Rust  
Examiner-in-Charge

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